

City, Town and District Reserves

Under state statutes, cities, towns and districts are permitted to establish [reserve funds](#) to provide for extraordinary or unforeseen expenditures. A reserve can be established and funded as a line-item in the annual budget, or it can be created by a separate budget article and funded through a transfer from a specified revenue source. The annual, cumulative reserve balance cannot exceed five percent of the prior year property tax levy in a town ([MGL Ch. 40, Section 6](#)), three percent in a city ([Ch. 40, Section 5](#)) or five percent of the prior year's receipts in a district ([Ch. 40, Section 5C](#)).

Transfers-out of a reserve require a majority vote of a town finance committee, a city council on recommendation of the mayor, and a district prudential committee, if any, otherwise by vote of the district commissioners. Expenditures cannot be made directly from the reserve fund. Instead, funds must be transferred to another account, even if newly created, against which the charge is then posted.

In practice, the amount appropriated to reserves reflects a financial management decision. During difficult economic periods, a higher reserve can meet an expectation of more frequent transfer requests from departments which struggle with lean budgets. During periods of revenue growth, when more spending latitude is given to departments, fewer requests are likely and a lower reserve balance is justified. Otherwise, there is no consensus on the appropriate reserve fund size in absolute dollars or as a percentage of total budget. Historical practice can serve as a guide if reserve fund transfers have been tightly managed under consistent rules.

Under state law, reserve fund transfers can be made:

"...to provide for extraordinary or unforeseen expenditures that could not be anticipated before the setting of the tax rate, or could not be determined when the budget was approved..."

Generally, if a diligent budget process could have anticipated the cost, then it does not qualify as unforeseen. However, the definition of an emergency falls, in the first instance, to the finance committee, city council or district and can include circumstances where delays to act would be prohibitively costly, or when the amount requested is too small to justify the expense of calling a special town meeting. Common sense should prevail in these instances. Ultimately, reserve transfers cannot be used to by-pass, or render invalid, a legitimate town meeting decision, or the budget review approval process in cities and districts.

Finally, funds in a reserve account cannot be earmarked for a particular purpose. Even if so targeted, the vote would not be binding on the city council, town finance committee or district prudential committee. At year end, any remaining reserve fund balance closes to free cash.